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July 7, 2021

Gary Gensler
Chairman
U.S. Securities and Exchange Commission (SEC)
100 F Street NE
Washington, DC 20549

Dear Chairman Gensler,

I write to request information regarding the Security and Exchange Commission's (SEC's) authority to properly regulate cryptocurrency exchanges and to determine if Congress needs to act to ensure that the SEC has the proper authority to close existing gaps in regulation that leave investors and consumers vulnerable to dangers in this highly opaque and volatile market.

Cryptocurrency exchanges are platforms where individuals buy and sell cryptocurrencies.¹ These exchanges vary in the type of cryptocurrencies they allow individuals to trade, the fees charged to consumers for using the platform, the disclosures they provide, and whether or not the exchange simultaneously keeps crypto assets in custody. As demand for cryptocurrencies has grown in recent years, the amount of trading activity on cryptocurrency exchanges has also grown, particularly amongst the largest exchanges.² The volume of trading on Coinbase, the largest cryptocurrency exchange in the United States, grew from \$30 billion in the first quarter of 2020 to \$335 billion in the first quarter of 2021, a more than 10-fold increase.³ Moreover, Coinbase recently became the first major cryptocurrency company to list its shares on a U.S. stock exchange when it began trading on the Nasdaq in April 2021 – giving “mainstream investors who may be wary of directly buying risky digital securities the ability to own stock in a Securities and Exchange Commission-approved business that facilitates the transactions.”⁴

¹ Congressional Research Service, “Digital Assets and SEC Regulation,” Eva Su, January 30, 2020, https://www.crs.gov/Reports/R46208?source=search&guid=9da4d9162360473c967131c5f8e5c87b&index=0#_Toc31292659.

² Forbes, “Crypto Exchanges And Bitcoin Are Poised For Massive Growth By 2030,” Leeor Shimron, June 20, 2020, <https://www.forbes.com/sites/leeorshimron/2020/06/20/crypto-exchanges-and-bitcoin-are-poised-for-massive-growth-by-2030/?sh=12049da73f83>; Yahoo Finance, Big Three Crypto Exchanges Handle 77% Of Global Trading Volume, Says New BDC Consulting Study, BTC Peers, April 24, 2021, <https://finance.yahoo.com/news/big-three-crypto-exchanges-handle-171755919.html>.

³ Coinbase, Letter to Shareholders, First Quarter 2021 Earnings, May 13, 2021, https://s27.q4cdn.com/397450999/files/doc_financials/2021/q1/Q1'21-COIN-Shareholder-Letter.pdf.

⁴ New York Times, “Coinbase’s Public Listing is a Cryptocurrency Coming-Out Party,” Erin Griffith, April 14, 2021, <https://www.nytimes.com/2021/04/14/business/coinbase-ipo-stock.html>; Coindesk, “Coinbase Direct Listing

The increased use of cryptocurrency exchanges presents unique risks to consumers. Although they describe themselves as cryptocurrency “exchanges,” these platforms lack the same types of basic regulatory protections as traditional national securities exchanges like the New York Stock Exchange or Nasdaq.⁵ And even though they share many features of traditional securities exchanges, such as “bring[ing] together buyers and sellers, execut[ing] trades, and display[ing] prices,”⁶ cryptocurrency exchanges may be able to escape federal regulation if the digital asset being traded does not qualify as a security under federal law.

As you acknowledged in May, “these exchanges do not have a regulatory framework at the SEC or at our sister agency, the Commodity Futures Trading Commission,” and as a result, “there’s really no protection around fraud or manipulation.”⁷ Instead, these platforms are generally subject to state-level regulations for money transfer or payment services.⁸ These regulations were not initially designed to provide oversight for sophisticated, exchange-like operations and are insufficient to ensure a safe cryptocurrency marketplace.⁹

The lack of regulation ensures that “investors have no way of knowing whether the trading volume and prices they report reflect real activity or market manipulation.”¹⁰ In order to receive a higher ranking on sites that list cryptocurrency exchanges, “many exchanges routinely fake their volumes to attract more coins and users.”¹¹ One study indicated that 95% of the volume of trading of Bitcoin listed on CoinMarketCap, a website used to measure cryptocurrency trading volume, “is fake and/or non-economic in nature.”¹² According to another study, half of the increase in the price of Bitcoin in 2017 was due to manipulation by a single entity trading on some of the major exchanges, suggesting that “instead of thousands of investors moving the price of Bitcoin, it’s just one large one.”¹³

⁵ Gets \$100B+ Valuation as Share Price Jumps in Nasdaq Debut,” Bradley Keoun, Damanick Dantes, April 14, 2021, <https://www.coindesk.com/coinbase-shares-crypto-exchange-stock-listing-nasdaq>.

⁶ Congressional Research Service, “Digital Assets and SEC Regulation,” Eva Su, January 30, 2020, https://www.crs.gov/Reports/R46208?source=search&guid=9da4d9162360473c967131c5f8e5c87b&index=0#_Toc_31292659.

⁷ *Id.*

⁸ Barron’s, Cryptocurrency Exchanges Need Direct Regulation, SEC Chair Says,” Avi Salzman, May 6, 2021, <https://www.barrons.com/articles/cryptocurrency-exchanges-regulation-sec-coinbase-51620335275>.

⁹ Congressional Research Service, “Digital Assets and SEC Regulation,” Eva Su, January 30, 2020, https://www.crs.gov/Reports/R46208?source=search&guid=9da4d9162360473c967131c5f8e5c87b&index=0#_Toc_31292659.

¹⁰ *Id.*

¹¹ Bloomberg, “On Crypto Exchanges, the Trades Don’t Always Add Up,” Olga Kharif, July 25, 2019, <https://www.bloomberg.com/news/articles/2019-07-25/on-crypto-exchanges-the-trades-don-t-always-add-up#:~:text=Outside%20the%20blockchain%2C%20transaction%20data%20is%20vulnerable%20to%20manipulation>

¹² *Id.*

¹³ Bitwise Asset Management Presentation to the U.S. Securities and Exchange Commission, May 19, 2019, <https://www.sec.gov/comments/sr-nysearca-2019-01/srnysearca201901-5164833-183434.pdf>.

¹⁴ John Griffin and Amin Shams, “Is Bitcoin Really Untethered?,” Journal of Finance, June 15, 2020, <https://onlinelibrary.wiley.com/doi/full/10.1111/jofi.12903>; Yahoo News, “A single whale on Bitfinex likely manipulated bitcoin’s historic surge in 2017, academics say,” Yogita Khatri, November 9, 2019, <https://news.yahoo.com/single-whale-bitfinex-likely-manipulated-073100397.html>.

These regulatory gaps also extend to the way that cryptocurrency exchanges hold an individual's crypto-assets, which would not be allowed on a traditional securities exchange.¹⁴ As a result, cryptocurrency traded on exchanges is "deposited and probably co-mingled with the deposits of others. It is not recorded on the blockchain; it is represented by an entry in an electronic, centralized ledger. It is uninsured and there is no guarantee [the trader] will get it. [Traders] must rely on—trust—the intermediary."¹⁵ Additionally, because cryptocurrency exchanges lack the same type of regulation as traditional securities exchanges, they can also engage in practices like proprietary trading and wash trading to take advantage of their customers without sufficient disclosures.¹⁶ An investigation of several major cryptocurrency exchanges by the New York State Office of the Attorney General in 2018 found that nearly 20% of the executed volume on Coinbase's platform was attributable to its own trading, exposing customers to liquidity risks they may not be aware of.¹⁷

The harms to consumers as a result of this under-regulated market are real and continue to proliferate in the absence of effective SEC regulations. During the six-month period from October 2020 to March 2021, nearly 7,000 people reported losses from cryptocurrency scams, resulting in a cumulative \$80 million lost—"about twelve times the number of reports and nearly 1,000% more in reported losses" compared to the same period a year earlier.¹⁸ Scams have surged on "decentralized finance" (DeFi) platforms in particular, which offer investors higher interest rates and whose developers are often anonymous – making it "easy to carry out 'rug pulls,' a scam in which unscrupulous operators raise money for a project, only to abscond with an investors' funds."¹⁹ According to reports, "[f]rom January through April, DeFi fraudsters stole \$83.4 million, more than double the haul from all last year."²⁰ Investors may also be exposed to risks indirectly as publicly traded firms amass their own cryptocurrency holdings. News reports suggest that MicroStrategy, a business intelligence firm, may be serving as a "kind of pseudo Bitcoin ETF...enabling investors to get exposure to Bitcoin without owning it."²¹

As the cryptocurrency markets continue to grow and expand, the lack of regulation to provide basic investor protections is unsustainable. The SEC regulates national securities exchanges, and cryptocurrency exchanges that operate in a similar manner should be subject to similar regulatory standards. To better understand the SEC's existing authority to protect consumers and investors who participate in cryptocurrency exchanges, and the potential need for Congress to

¹⁴ Brookings, "It's Time to Strengthen the Regulation of Crypto-Assets," Timothy G. Massad, March 2019, <https://www.brookings.edu/wp-content/uploads/2019/03/Timothy-Massad-Its-Time-to-Strengthen-the-Regulation-of-Crypto-Assets-2.pdf>.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Office of the New York State Attorney General, "Virtual Markets Integrity Initiative Report," Barbara D. Underwood, September 18, 2018, <https://virtualmarkets.ag.ny.gov/#key-findings>.

¹⁸ Federal Trade Commission, "Cryptocurrency buzz drives record investment scam losses," Emma Fletcher, May 17, 2021, <https://www.ftc.gov/news-events/blogs/data-spotlight/2021/05/cryptocurrency-buzz-drives-record-investment-scam-losses>.

¹⁹ Wall Street Journal, "Crypto Frauds Target Investors Hoping to Cash In on Bitcoin Boom," Alexander Osipovich, June 7, 2021, <https://www.wsj.com/articles/crypto-frauds-target-investors-hoping-to-cash-in-on-bitcoin-boom-11623058380>.

²⁰ *Id.*

²¹ Decrypt, "Is MicroStrategy Becoming a De Facto Bitcoin ETF? Experts Disagree," Liam Frost, February 17, 2021, <https://decrypt.co/57977/is-microstrategy-becoming-a-de-facto-bitcoin-etf-experts-disagree>.

take additional action on these matters, I ask that you provide a response to the following questions by no later than July 28, 2021.

1. Do you believe that cryptocurrency exchanges are currently operating in a “fair, orderly, and efficient” manner? If not, what problems has the SEC identified that are associated with the use of these exchanges?
2. How do the characteristics of assets traded on cryptocurrency exchanges differ from those of assets traded on traditional securities exchanges? Do these characteristics warrant additional investor and consumer protections for cryptocurrency exchanges relative to those provided for traditional exchanges?
3. Describe the extent of the SEC’s existing authority to regulate existing cryptocurrency exchanges. To what extent does that authority differ from the agency’s authority over traditional securities exchanges?
4. Foreign regulators have moved to restrict cryptocurrency exchanges in their jurisdictions in recent years while calling for international coordination to address regulatory gaps.²² One specific regulatory challenge may arise from the unique organizational structure of some global exchanges. For example, Binance, one of the largest cryptocurrency exchanges in the world by trading volume, “is everywhere and yet based nowhere. The cryptocurrency exchange has processed trillions of dollars in trades this year as it transfers digital and conventional money around the world through a constellation of affiliates. And yet it has no headquarters.”²³ In your view, to what extent is international coordination needed to address gaps in the regulation of cryptocurrency exchanges and ensure the protection of investors and consumers in the United States?
5. In a recent address, Commodity Futures Trading Commission (CFTC) Commissioner Dan M. Berkovitz stated: “In a pure ‘peer-to-peer’ DeFi system... [t]here is no intermediary to monitor markets for fraud and manipulation, prevent money laundering, safeguard deposited funds, ensure counterparty performance, or make customers whole when processes fail. A system without intermediaries is a Hobbesian marketplace with each person looking out for themselves. Caveat emptor—‘let the buyer beware.’”²⁴ Berkovitz further argues that DeFi derivative instruments are likely illegal under the Commodity Exchange Act.²⁵
 - a. Do you agree with Commissioner Berkovitz’s assessment of DeFi platforms?

²² Wall Street Journal, “Binance Crypto Exchange Ordered to Cease U.K. Activities,” Anna Hirtenstein, June 27, 2021, <https://www.wsj.com/articles/binance-crypto-exchange-ordered-to-cease-u-k-activities-11624812672>; Bloomberg, “IMF Calls for Global Talks on Cryptocurrencies,” Shelly Hagan and Andrew Mayeda, January 18, 2018, <https://www.bloomberg.com/news/articles/2018-01-18/imf-calls-for-global-talks-on-digital-fx-as-bitcoin-whipsaws>.

²³ Financial Times, “Binance crackdown: regulators tussle with ‘wild west’ of crypto,” Adam Samson and Brooke Masters, July 2, 2021, <https://www.ft.com/content/a10c297f-c8dd-48b1-9744-09d4ff2e89ca>.

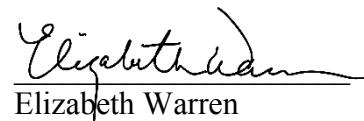
²⁴ Commissioner Dan M. Berkovitz, “Climate Change and Decentralized Finance: New Challenges for the CFTC,” June 8, 2021, <https://www.cftc.gov/PressRoom/SpeechesTestimony/opaberkovitz7>.

²⁵ *Id.*

- b. Do decentralized platforms raise similar investor and consumer protection concerns within the SEC's jurisdiction? If so, what challenges does the SEC face in addressing these concerns?
- c. Do the characteristics of decentralized cryptocurrency exchanges warrant additional investor and consumer protections relative to those needed for centralized cryptocurrency exchanges?

Thank you for your attention to this important matter, and I look forward to your response.

Sincerely,



Elizabeth Warren
Elizabeth Warren
United States Senator